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410782—41——1

In the Supreme Court of the United States

OCTOBER TERM, 1941

No. 349

THE DETROIT EDISON COMPANY, PETITIONER

v.

SECURITIES AND EXCHANGE COMMISSION

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Commission (R. 671)[1] is reported in 7 S. E. C. 968. The opinion of the Circuit Court of Appeals (R. 686) is reported in 119 F. (2d) 730.

[1] The original record in this case was voluminous. Counsel accordingly stipulated in the court below as to the portions to be printed. The printed record in this Court consists of the volume printed below (to which have been added the proceedings below), plus another supplemental volume filed by petitioner. All record references herein, however, relate to the original volume.

JURISDICTION

The decree of the Circuit Court of Appeals was entered May 12, 1941 (R. 685). The petition for a writ of certiorari was filed August 6, 1941. The jurisdiction of this Court is invoked by petitioner under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The petitioner, more than 10 per cent of whose voting securities are owned or controlled by a holding company (North American Company), applied to the Securities and Exchange Commission for an order declaring that it is not a "subsidiary company" under Section 2 (a) (8) of the Public Utility Holding Company Act of 1935. The basic question presented is whether the management or policies of petitioner are "subject to a controlling influence" by North American within the meaning of those provisions.

STATUTE INVOLVED

The applicable provisions of the Public Utility Holding Company Act of 1935 are set forth in the Appendix, *infra*, pp. 15–22.

STATEMENT

The petitioner, Detroit Edison Company, is an operating electric utility company. The North American Company, a holding company, owns or controls 19.28% of petitioner's voting securities.

In addition, 20.27% of petitioner's voting securities are owned by American Light & Traction Company, a subsidiary of the United Light and Railways Company, which in turn is a subsidiary of The United Light and Power Company (R. 671–672).

Petitioner is thus a "subsidiary company" in both the North American and United holding-company systems under Section 2 (a) (8) (A) of the Public Utility Holding Company Act, since more than 10% of its voting securities are owned by each of them. It brought this proceeding under the last paragraph of Section 2 (a) (8), asking the Securities and Exchange Commission to declare that it is not a subsidiary company in either system. The Commission ruled that petitioner is not a subsidiary in the United system but that it had failed to qualify for exemption with respect to the North American system since it had not shown that its management or policies "are not subject to a controlling influence" by North American within the meaning of those provisions. The findings of the Commission (R. 671–681), as approved by the Circuit Court of Appeals (R. 686–703), may be summarized as follows:

The petitioner, hereinafter referred to as Edison, was organized by North American in 1903. Its organization meeting was held at North American's offices and its first officers and directors were designated by North American. The details

of incorporation and organization were handled by the law firm of Sullivan & Cromwell, who were then, and are now, general counsel for the North American system, and since then have been counsel for Edison. Of the securities received by a syndicate, including North American, in return for the assets which were transferred to Edison, North American retained 14.73%. Its holdings of voting securities thereafter fluctuated from a low of 6.45% in 1924 to a high of 23.52% in 1931 (R. 674).

Edison's first president was also president of North American (R. 675). The first board of directors included the president of both, two other directors and members of the executive committee of North American, and a North American vice president. It also included a member of the firm of Sullivan & Cromwell; Dow, the manager of Edison; the president of General Electric Company, who became a director of North American in 1905; and two Detroit businessmen. The predominant influence of North American on Edison's board of directors has persisted since that time, and today at least four members of the present board are either associated with North American or derive their connection with Edison from North American (R. 675–678).

The personal stockholdings of Edison's officers and directors are negligible. No Edison stockholder, other than North American, appears ever

to have designated any of Edison's officers or directors, and no Edison officer or director appears to have had any relationship to any substantial Edison stockholder other than North American. (R. 677.) The continuity of the directors and the officers of Edison has been preserved through the use of the corporate proxy system. As the court below noted (R. 696):

> It is, and has been, the practice of the company to organize a proxy committee each year named by its directors, under the form of which the committees have always been instructed to vote for retiring directors if they were available. Between 1903 and 1910, an average of 80% of stockholders' votes cast at meetings were by proxy and since that time the percentage has varied from 90% to 100%.

This proxy machinery was effective to defeat United's attempt to procure representation on Edison's board of directors. Between 1925 and 1931 the United group, another public utility holding company system, acquired a large block of Edison's stock. Although North American's holdings of Edison's voting stock had fallen to a low of 6.54 per cent in 1924, it went into the market and kept close pace with United's purchases. In 1926, 1932, and 1934 United requested representation on Edison's board as a substantial stockholder, but the request was denied. In 1935, United tried unsuccessfully to force representa-

tion by attempting to break a quorum at the stockholders' meeting. It is still without representation on Edison's board (R. 679–680).

For years Edison participated with North American and its acknowledged subsidiaries in joint purchasing contracts. The arrangement was terminated in 1929, only when Edison's own purchasing power entitled it to terms commensurate with those obtainable under the joint contracts. For many years it was the only company, in addition to other statutory subsidiaries, which sent representation to North American's Station Advisory Committee, an engineers' group which compared operating methods.

North American served as Edison's fiscal agent until 1935. Until then, Edison's office, at which stock ledgers and other books were kept, was maintained in the offices of North American in New York. But thereafter, as stated by the circuit court of appeals (R. 695):

> For the sole purpose of avoiding the application of the Public Utility Holding Act, petitioner, in November, 1935 discontinued the use of the North American Company's offices and established its own on a different floor in the same building and put in charge thereof a former employee of the North American, who thereafter discontinued his connection with it. All officers of petitioner who were also officers of the North American Company at that time, resigned and petitioner's stock ledgers, its

> printed proxies and annual reports to stockholders were removed from the North American offices to petitioner's new offices and thereafter no mail was either sent or received for petitioner through the North American offices.[2] * * *

Against this background, the Commission determined that Edison had not sustained its burden of proving that it is not a subsidiary of The North American Company.

ARGUMENT

The narrow issue involved is whether Edison bore the burden of showing before the Securities and Exchange Commission that it is not a subsidiary of North American. The decision of the court below that it had not borne that burden is correct and does not call for further review.

1. Since 19.28 percent of Edison's voting securities are owned by North American, Edison is a "subsidiary company" of North American under Section 2 (a) (8) (A) of the Public Utility

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[2] These changes were all suggested to Edison by North American. In 1935 two Detroit officials of Edison went to New York and conferred with Sullivan & Cromwell and North American relative to changes necessary as the result of the passage of the Act. They wrote to Mr. Dow, president of Edison, as follows (Com. Ex. No. 34):

> Mr. Piske [North American's secretary] and Mr. Crispell [Sullivan & Cromwell partner] stressed the point that these changes will be of particular benefit to the Detroit Edison Company in eliminating any appearance of control by North American Company, and that it is desirable to have the Detroit office and officers handle as much as possible of the work now handled in New York.

Holding Company Act. But under those provisions the Commission is required upon application to declare that a company is not a subsidiary if it finds certain facts, one of which is that—

> (iii) the management or policies of the applicant are not subject to a controlling influence, directly or indirectly, by such holding company (either alone or pursuant to an arrangement or understanding with one or more other persons) so as to make it necessary or appropriate in the public interest or for the protection of investors or consumers that the applicant be subject to the obligations, duties, and liabilities imposed in this title upon subsidiary companies of holding companies. * * *

In this case the Commission refused to find that Edison's management or policies are not "subject to a controlling influence, directly or indirectly," by North American. The record shows that there was substantial evidence supporting the Commission's action, and the court below therefore properly declined to upset its ruling.[3] As this Court remarked with respect to a cognate issue in

[3] The Government argued below and intends to renew the contention in this Court if certiorari be granted that the order of the Commission can be sustained on the alternative ground that petitioner failed also to show that it is not "controlled" by North American in the manner specified in condition (i) of section 2 (a) (8).

Rochester Tel. Corp. v. *United States,* 307 U. S. 125, 145:

> Investing the Commission [Federal Communications] with the duty of ascertaining "control" of one company by another, Congress did not imply artifical tests of control. This is an issue of fact to be determined by the special circumstances of each case.

The record shows that Edison was organized by North American; that its board of directors was entirely designated by North American; that the presence of North American representatives on its board of directors has continued throughout the years; that by reason of the management's control of proxies no other stockholder has been able to designate members of the board. The record also shows close collaboration between Edison and North American in the past in a variety of ways. Although many of the formal indicia of collaboration (such as occupancy of same office space, etc.) were eliminated in 1935 in an apparent attempt to avoid regulation, the record does not disclose any significant change in the essential relationship between the companies. Indeed, the elimination of some of the formal indicia, at the suggestion of North American and its counsel, emphasizes rather than detracts from the persistence of the basic relationship.

In these circumstances, the Commission was entirely justified in refusing to grant exemption to petitioner, and its determination in turn was properly left undisturbed by the court below. "So long as there is warrant in the record for the judgment of the expert body it must stand." *Rochester Tel. Corp.* v. *United States,* 307 U. S. 125, 145–146.

2. The fact that the relationship between petitioner and North American gives the latter a potential controlling influence over petitioner is sufficient. Petitioner's suggestion that the statute requires actual domination of its affairs by the holding company is without merit. The ever present threat of domination, i. e., the power to control, is what the statute was obviously concerned with. Compare *Rochester Tel. Corp.* v. *United States,* 307 U. S. 125, 145 where the Court approved a finding of control by the Federal Communications Comission under circumstances where one company merely had the "power to control" the functions of another, rather than actual domination of its affairs.

Similarly, it is not necessary, as contended by petitioner, that the relations between petitioner and North American are presently leading to or have led to evil results. The actual existence or non-existence of any of the evils detailed in Section 1 (b), Appendix, *infra,* pp. 15–16, is not material. Section 1 (b) declares that the national

public interest, as well as the interests of investors or consumers—

are or *may be* adversely affected—

* * * * *

(2) when subsidiary public-utility companies are subjected to excessive charges for services, construction work, equipment, and materials, or enter into transactions in which evils result from an absence of arm's length bargaining or from restraint of free and independent competition; * * * [Italics supplied.]

Congress thus enumerates certain situations which it considers *potentially* harmful to the public interest, and in order to protect the public interest later in the Act prohibits service, sales, and construction contracts between holding companies and their subsidiaries.[4] No attempt is made in the Act to confine the operation of its regulatory provisions to holding company systems concerning which "evil" had been discovered by the investigations referred to in Section 1 (b). On the contrary, the primary purpose of the statute is not to punish abuse, but to prevent its occurrence. To that end, innocent as well as harmful transactions are necessarily included in the enumeration of Section 1 (b) (2) above, if by their nature they are susceptible of results inimical to the public interest. It must therefore be clear that in referring in Section 2 (a) (8) to a "controlling influence * * * so as to make it necessary *or* ap-

[4] Section 13 (a), Appendix, *infra*, pp. 20–21.

propriate in the public interest * * * that the applicant be subject to the obligations * * *" [italics supplied] of the Act, Congress was simply adverting to the potential evils previously outlined in Section 1 (b).

3. Petitioner contends that the Commission has not made "jurisdictional" findings which would justify the exercise of the commerce power over its activities. But even if such findings were necessary, petitioner's position would not be advanced, for petitioner itself has initiated these proceedings, asking for an exemption from the otherwise applicable provisions of Section 2 (a) (8) (A); and if these proceedings are a nullity, petitioner is left just where it started, namely, without its desired exemption.

Moreover, no such "jurisdictional" findings are necessary. The Act does not require each subsidiary to be engaged in interstate commerce. The commerce clause comes into play only at the points where the activities of the companies are regulated, and petitioner may not here, any more than was done in *Electric Bond and Share Co.* v. *Securities and Exchange Commission,* 303 U. S. 419, 443, challenge the application of the statute *in limine* with respect to all its activities under the cloak of a proceeding to establish that it is not a subsidiary.

4. Finally, there is no substance to petitioner's contention that the decision below grants the Com-

mission a delegation of power to determine for itself the scope of its own jurisdiction. The court below did not hold that the Commission had power to determine arbitrarily what constituted "controlling influence." On the contrary, the court said only that since controlling influence may be exerted in varied and subtle ways, Congress could not promulgate a code so specific as to adapt itself to all possible contingencies and evils; and although seven types of control were recognized at the time of the passage of the Act, Congress refrained from laying down rules of thumb for the determination of controlling influence in recognition of the fact that other forms of control "may develop from the urge of individuals to avoid public regulation" (R. 699).

That the court did not hold that the Commission has discretionary power to determine the meaning of the phrase "controlling influence" is confirmed by the fact that the court itself defined the meaning of the phrase, as follows (R. 699):

> This phrase should be construed in the light of the purpose of the Act of which it is a part, and when understood in this setting and in the light of its ordinary signification, it means the act or process, or power of producing an affect which may be without apparent force or direct authority and is effective in checking or directing action, or exercising restraint or preventing free action. The phrase as here used

does not necessarily mean that those exercising controlling influence must be able to carry their point. A controlling influence may be affective without accomplishing its purpose fully.

CONCLUSION

The decision below is correct. It turns largely upon the facts and presents no question worthy of further review. The petition should be denied.

Respectfully submitted.

CHARLES FAHY,
Acting Solicitor General.
ARNOLD RAUM,
Special Assistant to the Attorney General.
CHESTER T. LANE,
General Counsel,
CHRISTOPHER M. JENKS,
Assistant General Counsel,
LAWRENCE S. LESSER,
J. LEONARD TOWNSEND,
HOMER KRIPKE,
Attorneys,
Securities and Exchange Commission.

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